FIL

SUPREME

ANNE P. HUMPHREY,
BERT PATTERSON HUMPHREY
ceased, JOE A. HUMPHREY
Executor, DEANE HUMPHREY, [illegible]
HUMPHREY AND JOE A. HUMPHREY

v.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR A WRIT OF CERTIORARI TO THE
STATES CIRCUIT COURT OF APPEALS FOR THE
CIRCUIT AND BRIEF IN SUPPORT THEREOF

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SEPTEMBER, 1947

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COMMERCIAL RECORDER, FORT WORTH, TEXAS—9-47-47—50

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No.....

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1947

ANNE P. HUMPHREY, ESTATE OF ALBERT PATTERSON HUMPHREY, Deceased, JOE A. HUMPHREY, Independent Executor, IRENE HUMPHREY, LAYTON HUMPHREY AND JOE A. HUMPHREY,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for Writ of Certiorari to The United States Circuit Court of Appeals for the Fifth Circuit

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Anne P. Humphrey, the Estate of Albert Patterson Humphrey, deceased, Joe A. Humphrey, Independent Executor, Irene Humphrey, Layton Humphrey, and Joe A. Humphrey, pray that a Writ of Certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fifth Circuit entered in the above cause on July 2, 1947, insofar as the same affirmed the decisions of the Tax Court of the United States.

Question Presented

One single question is presented by these proceedings. It is whether the gain realized in 1941 by the

Partnership Joe A. Humphrey Company (includable for taxation in the individual returns of the several partners and their respective spouses) from applying lien notes of Ellis Petroleum Company in partial satisfaction of the price bid by the partnership (a secured creditor) for certain pledged assets of Ellis Petroleum Company, bankrupt, at a lawful sale of such pledged assets, is taxable as ordinary income under the general provisions of Section 22 of the Internal Revenue Code, or whether (as contended by petitioners) under the provisions of Treasury Regulations having the force and effect of law (Sec. 19.23 (k) of Treasury Regulations 103) specifically dealing with the purchase by a creditor of mortgaged or pledged property at a lawful sale thereof, and the provisions of Sec. 117 of the Internal Revenue Code, the resulting gain is taxable at Capital Gain rates. The partnership had no cost or other basis for gain or loss in the aforesaid notes as its entire investment therein had been charged off in a previous taxable year.

Statutes and Regulations Involved

INTERNAL REVENUE CODE (as Amended).

Sec. 22. Gross Income:

(a) General Definition.—"Gross income" includes gains, profits, and income derived from * * * trades, businesses, commerce, or sales, or dealings in property, whether real or personal growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction

of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

Sec. 111. Determination of Amount of, and Recognition of, gain or loss.

(a) Computation of Gain or Loss.—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in Section 113(b) for determininf gain * * *.

(b) Amount Realized.—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

Sec. 113. Adjusted Basis for Determining Gain or Loss.

(a) Basis (unadjusted) of property.—The basis of property shall be the cost of such property; except that * * *

(b) Adjusted basis.—The adjusted basis * * * shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) General rule.—Proper adjustment in respect of the property shall in all cases be made—

(A) For expenditures, receipts, losses, or other items properly chargeable to capital account, * * *.

Sec. 117. Capital Gains and Losses.

(a) Definitions.—As used in this chapter—

(1) CAPITAL ASSETS.—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or busineess), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(1); * * *

(4) LONG-TERM CAPITAL GAIN.—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 18 months, if and to the extent such gain is taken into account in computing net income; * * *

(b) Percentage taken into account.—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 18 months;

66-2/3 per centum if the capital asset has been held for more than 18 months but not for more than 24 months.

50 per centum if the capital asset has been held for more than 24 months.

(c) Alternative taxes.—

(1) IN CASE OF NET LONG-TERM CAPITAL GAIN.—If for any taxable year a taxpayer (other than a corporation) derives a net long-term capital gain, there shall be levied, collected, and paid, in lieu of the tax imposed by sections 11 and 12, a tax determined as follows, if and only if such tax is less than the tax imposed by such sections:

A partial tax shall first be computed upon the net income reduced by the amount of the net long-term capital gain, at the rates and in the manner as if this subsection had not been enacted, and the total tax shall be the partial tax plus 30 per centum of the net long-term capital gain.

(2) IN CASE OF NET LONG-TERM CAPITAL LOSS.—If for any taxable year a taxpayer (other than a corporation) sustains a net long-term capital loss, there shall be levied, collected, and paid, in lieu of the tax imposed by sections 11 and 12, a tax determined as follows, if and only if such tax is greater than the tax imposed by such sections:

A partial tax shall first be computed upon the net income increased by the amount of the net long-term capital loss, at the rates and in the manner as if this subsection had not been enacted, and the total tax shall be he partial tax minus 30 per centum of the net long-term capital loss. * * *

Sec. 183. Computation of Partnership Income.

(a) General Rule.—The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except as provided in subsections (b) and (c).

(b) Segregation of Items.—

(1) Capital Gains and Losses.—There shall be segregated the short-term capital gains and losses and the long-term capital gains and losses, and the net short-term capital gain or loss and the net long-term capital gain or loss shall be computed.

(2) Ordinary Net Income or Loss.—After excluding all items of either short-term or long-term capital gain or loss, there shall be computed—

(A) An ordinary net income which shall consist of the excess of the gross income over the deductions; or

(B) An ordinary net loss which shall consist of the excess of the deductions over the gross income.

TREASURY REGULATIONS 103 (1940):

Sec. 19.23(k)-3. * * * *If Mortgaged or pledged property is lawfully sold (whether to the creditor or another purchaser)* for less than the amount of the debt, and the mortgagee or pledgee ascertains that the portion of the indebtedness remaining unsatisfied after such sale is wholly or partially uncollectible, and charges it off, he may deduct such amount (to the extent that it constitutes capital or represents an item the income from which has been returned by him) as a bad debt for the taxable year in which it is ascertained to be wholly or partially worthless and charged off. In addition, *if the creditor buys in the mortgaged or pledged property, LOSS* or *GAIN is realized measured by the difference between the amount of those obligations of the debtor which are applied to the purchase or bid price of the property (to the extent that such obligations constitute capital or represent an item the income from which has been returned by him) and the fair market value of the property.* The fair market value of the property shall be presumed to be the amount for which it is bid in by the taxpayer in the absence of clear and convincing proof to the contrary. If the creditor subsequently sells the property so acquired, the basis for determining gain or loss is the fair market value of the property at the date of acquisition.

Accrued interest may be included as part of the deduction only if it has previously been returned as income. (Emphasis supplied).

Statement

Throughout the calendar year 1941, petitioners Anne P. Humphrey and Albert Patterson Humphrey* (husband and wife), Layton A. Humphrey, and Joe A. Humphrey were members of the partnership Joe A. Humphrey Company, which was engaged in the oil business and had its offices in Dallas, Texas. Anne P. Humphrey and Albert Patterson Humphrey, together, had a one-half (½) interest, and Layton A. Humphrey and Joe A. Humphrey each had a one-fourth (¼) interest in the partnership. This partnership kept its books on an accrual basis (R. 118). Irene Humphrey was married to Layton Humphrey on March 21, 1941, and they continued to be husband and wife from that date (R. 119). Under the laws of Texas all of the income and deductions of Anne P. Humphrey and Albert Patterson Humphrey for the year 1941 were the community income and deductions of these two petitioners; and all the income and deductions of Irene Humphrey and Layton Humphrey from and after March 21, 1941, were the community income and deduction of those two petitioners. Joe A. Humphrey was unmarried throughout 1941 (R. 119).

*Deceased.

At December 15, 1939, Joe A. Humphrey Company held notes executed by Ellis Petroleum Company in the aggregate face amount of $63,758.25, secured by mortgage deeds of trust on property owned by debtor corporation. The investment of Joe A. Humphrey Company

in these notes amounted to $42,200.00. (R. 122). On or about December 15, 1939, a proceeding was filed in the United States District Court for the Eastern District of Texas for the corporate reorganization of Ellis Petroleum Company in connection with which that corporation was adjudged bankrupt. In this proceeding the Joe A. Humphrey Company, acting by and through Joe A. Humphrey, one of its partners, filed proof of its claim against Ellis Petroleum Company for the aforesaid indebtedness in the amount of $63,758.25. The investment of Joe A. Humphrey Company in these notes, amounting, as aforesaid, to $42,200.00, was charged off by Joe A. Humphrey Company in its income tax return for the calendar year 1939 (filed early in 1940) as worthless and uncollectible, with a resulting tax benefit. The amount charged off represented the entire basis for gain or loss of Joe A. Humphrey Company in the notes (R. 122, 123), and thereafter the basis for gain or loss of such notes was zero.

On September 5, 1941, on petition of the trustee in bankruptcy, and the application of the Mercantile National Bank at Dallas, Texas (a secured creditor), before there had been any adjudication as to the validity of the various creditors' claims filed in the Ellis Petroleum Company bankruptcy proceeding, or the respective priorities of such claims, the referee in bankruptcy entered an order of sale directing the trustee to sell at public auction on the 15th day of October, 1941, certain described property of the Ellis Petroleum Company, bankrupt. The order of sale directed that

the property be sold free and clear of all liens, claims and interest of every character (except that certain equipment was to be sold subject to the rights of International Derrick & Equipment Company), and that all liens and claims of every character against the property were to be transferred to the proceeds of the sale, without determination by the Court of the validity and priority of such claims. It was further directed that the sale was to be made for cash, providing, however, "that in the case of any lienholder whose lien is inferior to the lien of the Mercantile National Bank at Dallas, a bid of not less than $25,000.00 cash, together with an additional cash sum not less than the unpaid balance of the claim of the Mercantile National Bank at Dallas, and all other liens prior to the bidding lienholders claim, shall be deemed a cash bid for the total amount of all such cash and credit." (R. 123).

At the sale so authorized, Joe A. Humphrey Company was represented by Joe A. Humphrey and Lanham Crowley, the latter being attorney for the partnership. The bidding started at about $135,000.00 for the property offered for sale, and the property was ultimately bid in, jointly, by Joe A. Humphrey Company and McClanahan & Venable (holders of obligations of Ellis Petroleum Company in the face amount of $45,725.16, of equal dignity and on a parity with the lien securing the notes held by Joe A. Humphrey Company (R. 186, 187)), for a final bid price of $160,000.00. There were other bidders at this public auction, at least one of whom did not hold any obligations of

the Ellis Petroleum Company (R. 124). After such bid had been made, the referee in bankruptcy required Joe A. Humphrey Company, and McClanahan & Venable, the successful bidders, to pay $10,155.87 in cash on their said bid price, in addition to the $25,000.00 in cash required in the Notice of Sale. (R. 168).

When this additional cash payment was demanded of them by the referee in Bankruptcy, Joe A. Humphrey Company and McClanahan & Venable attempted to withdraw their bid, but the referee took the position that he had authority under the bankruptcy law to compel them to comply with the bid and pay the amount thereof in any form he might require, and refused them the right to withdraw the same. They protested to the referee informally, but took no legal action to set aside his action in the premises. The sale was confirmed on November 8, 1941, and on December 3, 1941, the property was conveyed to Joe A. Humphrey Company, to the extent of sixty per cent (60%) and to McClanahan & Venable, to the extent of 40%. Its share, $96,000.00, of the total bid price for the property of $160,000.00, was paid by Joe A. Humphrey Company (R. 124, 163, 217), as follows:

Cash—required by the Notice of Sale	$15,000.00
Cash—additional amount, required by the Trustee	6,093.52
Paid Mercantile National Bank in cash	27,475.44
Paid by applying to the bid price notes of Ellis Petrolem Company at face	

amount (R. 163) 47,431.04

Total $96,000.00

By a later settlement agreement (reached in 1942) the share of Joe A. Humphrey Company, or $6,093.52, in the cash totaling $10,155.87 that the successful bidders had been required to pay, in addition to the cash required in the Notice of Sale, was returned to it (R. 124).

The notes of Ellis Petroleum Company involved had been held by Joe A. Humphrey Company for more than twenty-four months (R. 124).

With respect to the foregoing transactions, the Commissioner of Internal Revenue included in the gross income of Joe A. Humphrey Company, as ordinary income, the sum of $63,758.25, with the following explanation:

> "There has been included in the gross income of the Joe A. Humphrey Company the sum of $63,758.25, representing the credit given the partnership in connection with the purchase by the Joe A. Humphrey Company of properties from the Ellis Petroleum Corporation. Said sum represents the face value of notes written off the books by the partnership and allowed as a deduction in a prior year, together with other charges, for which the partnership received a tax benefit" (R. 104).

Before the Tax Court, the Commissioner conceded that the maximum extent of the income involved in

this issue was $47,434.04 instead of the $63,758.25 determined by him (R. 138). The Tax Court sustained the determination of the Commissioner, except to the extent that he thus conceded error, and held that Joe A. Humphrey Company derived $47,431.04 ordinary income from the transaction. The Circuit Court of Appeals affirmed.

Specification of Errors To Be Urged

The Circuit Court of Appeals erred:

(1) In the holding and deciding that Joe A. Humphrey Company and the partners in such partnership (and their respective spouses) realized ordinary income in 1941 from the disposition of obligations of Ellis Petroleum Company in that year.

(2) In failing to hold and decide that the gain realized in 1941 by Joe A. Humphrey Company and the partners thereof from the disposition of obligations of Ellis Petroleum Company constituted a long-term capital gain taxable under the provisions of Section 117 of the Internal Revenue Code.

Reasons for Granting the Writ

The writ should be granted because the holding of the Court below completely ignored and failed to apply applicable provisions of the Internal Revenue Code, and of Treasury Regulations of long standing having the force and effect of law; because the holding of the

court below is in direct conflict with the legal principles applied by the United States Circuit Court of Appeals for the Sixth Circuit in *Nichols, et al, v. Commissioner of Internal Revenue*, 141 F. 2d 870, decided April 5, 1944, and is further in conflict with the legal principles applied by the United States Circuit Court of Appeals for the First Circuit in *Hadley Falls Trust Company v. United States*, 110 F. 2d 887, decided March 29, 1940; and because the Court below decided an important question of federal law which has not been, but which should be, decided by this Court.

It is conceded by Petitioners that in 1941 the partnership Joe A. Humphrey and the individual partners thereof realized "gross income" within the meaning of Section 22 of the Internal Revenue Code (as amended) in the amount of $47,431.04 through the disposition of notes of Ellis Petroleum Company. The statutory provision in question, viz, Section 22 of the Internal Revenue Code, is so general as to render an interpretative regulation appropriate. Moreover, it does not deal with the question whether such "Gross Income" is taxable as ordinary income or as a capital gain.

If this transaction qualifies as a "sale or exchange," under the provisions of Section 117 of the Internal Revenue Code, the resulting gain is taxable as a capital gain instead of as ordinary income.

Since 1926 the Treasury Regulations have repeatedly classified a transaction of the type here involved as

an exchange of mortgage notes for land. Section 19.23(k)-3 of Treasury Regulations 103 (1940), which was in effect throughout the year 1941, so classifies such a transaction. In the *Appeal of Elliott S. Nichols and Anne D. Nichols*, 1 TC 328, the Tax Court of the United States, held that where mortgaged or pledged property was lawfully sold and the creditor bought in such mortgaged or pledged property by applying obligations of the debtor to the purchase or bid price of the property, the transaction constituted an exchange of the mortgage notes for the land and the resulting loss was a capital loss, the deductibility of which was governed and limited by the provisions of Section 117 of the Revenue Act of 1932, the counterpart of Section 117 of the Internal Revenue Code. The Circuit Court of Appeals for the Sixth Circuit in *Nichols, et al, v. Commissioner of Internal Revenue, supra*, sustained this holding but reversed the holding of the Tax Court that the principal amount of the obligations exchanged and the interest thereon should be segregated and, for tax purposes, dealt with separately. In the case at bar the Tax Court and the Circuit Court of Appeals for the Fifth Circuit, looking to Sec. 22 Internal Revenue Code alone, held that Joe A. Humphrey Company and the individual partners thereof realized ordinary income, and not capital gain, from the transfer of those obligations of Ellis Petroleum Company that were applied to the bid price of mortgaged property of the debtor bought in by such creditor at a lawful sale thereof. We respectfully assert that such holding was erroneous.

Because of the importance of the question here involved as to the scope and effect of Section 19.23(k)-3 of Treasury Regulations 103, because of conflicting decisions of different judges of Tax Court of the United States on the same question, and because of the conflict between the principles applied in the decision of the Court below in the instant proceeding with those applied by the Sixth Circuit Court of Appeals in *Nichols, et al, v. Commissioner of Internal Revenue, supra,* and *Hadley Falls Trust Company v. United States, supra,* it is believed that the writ should issue to the end that there may be an authoritative decision of this Court upon the question involved.

WHEREFORE, it is respectfully submitted that the petition should be granted.

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No.....

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1947

ANNE P. HUMPHREY, ESTATE OF ALBERT PATTERSON HUMPHREY, Deceased, JOE A. HUMPHREY, Independent Executor, IRENE HUMPHREY, LAYTON HUMPHREY AND JOE A. HUMPHREY.

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Brief in Support
of
Petition for Writ of Certiorari to The United States Circuit Court of Appeals for the Fifth Circuit

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Opinions Below

The opinion of the Circuit Court of Appeals is reported at .....F. 2d ..... The Tax Court of the United States entered its memorandum findings of fact and opinion in these proceedings on January 18, 1946. Such memorandum findings of fact and opinion (R. 115-142) were not published.

Jurisdiction

The judgment of the Circuit Court of Appeals was entered July 2, 1947. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by 43 Stat. 938 (U.S.C., Title 28, Sec. 347).

Statutes and Regulations Involved

The applicable statutes and Treasury regulations are fully set out in the petition for certiorari, at pages 2 to 7, to which reference is hereby made.

Question Presented

The question presented is whether the gain derived by a creditor from the application of obligations of a debtor in payment of the price bid for mortgaged or pledged property of the debtor upon a lawful sale thereof is subject to taxation as a capital gain under the provisions of Treasury Regulations 103, Section 19.23(k)-sions of Treasury Regulations 103, Section 19.23(k)-3, 3, and Section 117 of the Internal Revenue Code (as amended), or whether such gain is taxable as ordinary income under the general provisions of Section 22(a) of the Internal Revenue Code, where the investment of the tax payer in such obligations had been charged off in a prior year.

Statement

The statement of facts contained in the petition for certiorari (pages 8 to 13, supra) sufficiently de-

velops the salient facts. Reference to that statement is hereby made.

Specification of Errors To Be Urged

The Circuit Court of Appeals erred:

(1) In the holding and deciding that Joe A. Humphrey Company and the partners in such partnership (and their respective spouses) realized ordinary income in 1941 from the disposition of obligations of Ellis Petroleum Company in that year.

(2) In failing to hold and decide that the gain realized in 1941 by Joe A. Humphrey Company and the partners thereof from the disposition of obligations of Ellis Petroleum Company constituted long-term capital gains taxable under the provisions of Section 117 of the Internal Revenue Code.

Summary of Argument

(a) The sale by the trustee in bankruptcy on October 15, 1941, of mortgaged or pledged property belonging to Ellis Petroleum Company, a bankrupt, was a lawful sale of mortgaged or pledged property within the purview of Section 19.23(k)-3 of Treasury Regulations 103 (1940). Such property was sold to creditors holding liens against the same, one of whom was Joe A. Humphrey & Company, a partnership. Obligations of the debtor were applied to the purchase or bid price of the property. Since 1926 the Treasury Regulations

have repeatedly classified a transaction of this type as an exchange of the mortgage notes for land. The resulting gain is taxable as a capital gain and not as ordinary income: Section 117 (a), Internal Revenue Code (as amended); *Nichols, et al. v. Commissioner of Internal Revenue*, 1 TC 328; *Nichols, et al, v. Commissioner of Internal Revenue*, 141 F. 2d 870. The Tax Court of the United States and the Circuit Court of Appeals for the Fifth Circuit erred in holding and determining such gain to be taxable as ordinary income.

Argument

Section 22 of the Internal Revenue Code, as amended, requires that there be included in "gross income," among other things, gains, profits, and income derived from dealings in property. This section is undoubtedly broad enough to require that the gain derived in 1941 by Joe A. Humphrey Company from its dealings in notes of Ellis Petroleum Company, which amounted to $47,431.04, be included in gross income. But, Section 22 of the Internal Revenue Code does not provide to what extent the gain so realized shall be recognized for tax purposes, nor the rates at which the recognized gain is to be taxed.

Section 117 of the Internal Revenue Code does prescribe the manner of taxing gains and losses from sales or exchanges of capital assets. The notes of Ellis Petroleum Company held by Joe A. Humphrey Company at the beginning of 1941 constituted capital assets as

that term is defined in Section 117 of the Code. Accordingly, if the disposition made of those notes by Joe A. Humphrey Company in 1941 amounted to a sale or exchange thereof within the purview of Secction 117 of the Code, the resulting profit constituted a capital gain includable in income only to the extent provided in Section 117, and subject to taxation in the manner provided by that Section.

In 1926 a Treasury Regulation reasonably adapted to the administration of the income tax provisions of the Internal Revenue laws, insofar as sales of mortgaged or pledged property were concerned, was promulgated by the Treasury Department. Such Regulation remained substantially unchanged while the pertinent provisions of the Internal Revenue Act were repeatedly enacted. For the year 1941 it appeared as Section 19.23(k)-3 of Treasury Regulations 103 (1940). Under such circumstances the Regulation is to be given the same force and effect as the statute itself. *Nichols v. Commissioner of Internal Revenue*, 141 F. 2d 870.

The Regulation is based upon the theory that where mortgaged or pledged property is lawfully sold, if the creditor buys in the mortgaged or pledged property and applies obligations of the debtor held by him to the purchase or bid price of the property, then to the extent of the obligations so applied, the transaction constitutes the exchange of the obligations of the debtor for the property and, insofar as the income taxing acts are concerned, is to be treated in the same way as any other exchange of property for property.

It is true that the notes of Ellis Petroleum Company held by Joe A. Humphrey Company at January 1, 1941, had no basis for gain or loss in the hands of the partnership because the investment of the partnership therein had been charged off in a prior year. We respectfully assert that insofar as the question here before the Court is concerned, such prior-year charge-off does nothing more than to decrease the amount of the partnership's investment in such notes and correspondingly increase its gain from their disposition. It does not affect the *character* of the transaction, which under the Regulation remains, as it would have been absent such chargeoff, an exchange of notes for property. Such write-off is comparable to the writing off of depreciation sustained with respect to depreciable property, and other deductions of like character effecting basis. There is no provision of law that requires or permits part or all of a capital gain to be taxed as ordinary income merely because the *basis* of property sold or exchanged has been reduced by prior year deductions effecting basis, even though such prior year deductions reduced ordinary income. Only the *amount* and not the *character*, of the gain or loss from the sale or exchange of a depreciated or otherwise charged down capital asset, is affected by such prior year deductions.

The Circuit Court found that the cases cited and relied upon by the Tax Court in its opinion were not

decisive of this case (R. 225). However, it also thought that Sections 111 and 117 of the Internal Revenue Code could not apply to taxpayer's disposition of the notes of Ellis Petroleum Company involved in these proceedings "for they were not sold to a third person but were paid by the debtor through the bankruptcy court out of the proceeds of his property, as the decree of sale expressly states." (R. 225). This finding is directly contrary to stipulated facts (R. 163), and to the express requirement of the regulations that the transaction be deemed an exchange of notes for property, and not treated as an ordinary collection thereof.

Because Treasury Regulations 103, Section 19.23 (k)-3 is preceded by the caption "Uncollectible Deficiency Upon Sale of Mortgaged or Pledged Property" and the first sentences of such regulation permit the charge-off of a taxpayer's investment, if any, in *unapplied* obligations, the Circuit Court of Appeals considered that the Regulation had no application in the case at bar as Joe A. Humphrey Company had no basis for gain or loss with respect to the unapplied obligations of Ellis Petroleum Company remaining on hand after some of such obligations had been applied on the price bid by the partnership for certain pledged property of the debtor sold at lawful sale, as the investment of the partnership in such remaining

notes had been charged off and deducted from income in a prior year and the partnership had nothing more in them to lose.

But we are here dealing with *applied* obligations, not unapplied obligations, and we respectfully assert that in so holding the Circuit Court completely closed its eyes to that portion of the above-referred-to regulation which appears in italics at page 7... of the petition for certiorari herein. Such italicized portion of the cited Regulation is the only part thereof having any application to the particular facts obtaining in the case at bar.

The opinion of the court below, therefore, wholly ignored and failed to apply Treasury Regulations of long standing having the force and effect of law. It is directly in conflict with the principles laid down by the Circuit Court of Appeals for the Sixth Circuit in *Nichols, et al, v. Commissioner of Internal Revenue*, 141 F. 2d 870 (CCA-6th) and *Hadley Falls Trust Company v. United States*, 110 F. 2d 887 (CCA-1st), inclusive.

Conclusion

It is respectfully submitted that the decision below is erroneous; deals with an important question of federal law; conflicts with decisions of other Circuit Courts of Appeal; affirms a decision by a Judge of the Tax Court

of the United States that is directly in conflict with a decision of another Judge of the Tax Court of the United States on the same subject matter; and that the petition for certiorari should be granted and the decision below reversed.

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